

IT'S TIME TO ACCEPT REALITY

Avoiding the Five Deadly Sins of Financial Distress

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Most builders and developers must realize that their choices are very limited in the current economic environment. Instead, they must focus and plan to achieve a "least worst" solution. Unless you are one of the few well capitalized developers sitting on the sidelines, the guidelines in this article may help save your business. Unfortunately we have all seen otherwise well managed companies make business and financial decisions that result in the worst financial outcome possible. If you read below and recognize some or all of the following situations in your business, you should take action now.

Five Deadly Sins of Financially Distressed Builder/Developers

1. **Not being proactive.**

Doing nothing and waiting for the market to fix the problems is a sure-fire strategy for financial ruin. Every month that you wait wastes precious resources that are needed to create a real solution.

2. **Putting good money after bad.**

The banks will use every trick in their book to get you to commit what cash you have towards carrying their loans. Normally this is the right thing to do. However, and this is a crucial point, if the "real" market value of the encumbered assets is less than the debt basis then the bank owns the assets (because your equity is gone). You are just throwing your money away.

3. **Unjustified optimism.**

Believing the housing recovery is just around the corner is a risky and dangerous turnaround plan. After a solid year of horrible results in most markets, there are still many banks that have not written down or cleaned-up bad residential loan portfolios. Think what will happen when those foreclosed assets hit the market?

4. **Wasting time, money and effort negotiating short-term fixes.**

Forbearance agreements are, in many cases, a waste of time and only serve to keep the lawyers busy. The net result is that you will give up your legal rights and the bank will give you little of value. And this is most important - when negotiating a solution with the banks, it must be a complete restructure of your balance sheet, debt, even how your business is organized, that permits you to realistically go forward and run your business profitably. Otherwise you are working for the bank for FREE and are better off going home.

5. **Thinking that you can fix it yourself.**

Hiring restructuring professionals will send a message to

your creditors that they will face a serious situation.

Trying to get it done yourself or with your local CPA and corporate attorney is a prescription for disaster. You have your plate full in these difficult times. Professionals who do this full-time will know what the banks really can or cannot accept. They can insulate the builder from unpleasant discussions so that a future business relationship is maintained. The fact that bankruptcy can be worse for the bank than the debtor is an important negotiating tool. A good, seasoned team consisting of a bankruptcy attorney and a financial advisor may seem expensive, but the cost will be a fraction of potential losses and it may save your business and protect your family.

In order for much of the builder community to survive and take advantage of the opportunities that will eventually reappear, decisive action is required. This article is purposed so that each principal can make intelligent and informed decisions based on a very difficult set of facts.

The New Realities

The following are a few realities that must be accepted if you want to achieve the "least worst" outcome:

- Banks/bankers are not your friend. They are a business. Long term relationships mean very little and the banks will do what they believe is in their own, economic self interest.
- Your assets are probably worth less than the associated debt, and therefore your bank owns the assets - you now work for them. If assets worth \$10 million today are encumbered with \$20 million in debt, and you work for 24 months to recover \$15+ million for the bank, they will not pay you for getting them an additional \$5+ million, unless you make that deal today.
- Cash is king. Don't waste it by paying interest or principal without agreeing to a global restructuring plan. Under NO circumstances put additional cash, or pledge additional collateral, to the bank without a global restructuring plan.
- You need to engage legal counsel to analyze any guaranties, either personal or corporate, as well as their "collectability". If you do not have personal guaranties you are in control - start to act like it. If you have personal or corporate guaranties you must come to an agreement with ALL of your lenders simultaneously, not just the one that is the squeakiest wheel.
- The owners and/or management teams of 99% of homebuilder/developers do not have the experience,

expertise and time to negotiate with their lenders given the rapidly changing market dynamics.

- There is NO new outside debt or equity available without a balance sheet reflecting assets at realistic sustainable values.
- A Chapter 7 or 11 filing may or may not be necessary - but preparing for it may be very helpful in negotiations with your banks.
- If you act in an honest and ethical manner there should be minimal long term consequences with the lending community even if things get ugly. Your advisors can and should shield you.

Legal and financial advisors who really know what they are doing, offer marketplace intelligence, and bring credibility to you are very expensive but worth it. It will take months to complete any type of meaningful restructuring. Accept it and prepare for it.

What You Need to Do

1. Immediately hire legal and financial advisors who understand how the game is played. Hire the best you can afford. Some developers and builders are just starting to realize it is more important to hire advisors than paying the bank current.
2. Review with your legal advisors your personal financial planning to determine which personal and business assets are protected and which are at risk.
3. Work with your financial advisors to analyze what your assets are worth to the bank, not to you.
4. Work with both your legal and financial advisors to develop an overall comprehensive plan that addresses the entire debt structure as well as your guaranties. Don't expect your banks to help you develop this plan – they have different interests. Be prepared for this plan to change numerous times during the process.
5. Present a fully analyzed and documented plan to your lenders that they can take back to their internal decision-makers. Your banker does not have the time, motivation or resources to do this on your behalf.
Giving the bank a professionally prepared plan with the proper packaging, analysis and documentation will greatly improve the chances of approval/success.

To achieve a “least worst” outcome you need to be realistic and proactive immediately, otherwise you will likely not be here to enjoy the fruits of the next up market, whenever that may occur.

The Algon Group has been involved in restructuring over \$3 billion of real estate related debt over the past 18 months. In addition, we have met with and/or spoken to over 150 builder/developers around the country. Unfortunately, we have found most CEO's unwilling to accept the harsh realities of the situation and take the

necessary corrective actions. In many cases they have negotiated relatively small adjustments to their loans that do not solve any of the underlying problems, but makes them, their bankers and especially their attorneys feel better. Only a long-term solution that has resolved all of the financial issues will give you the best shot at a successful restructuring and a business that will survive.

The Algon Group is a financial advisor and investment banking firm based in Atlanta that specializes in distressed situations.

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